

Economic Crisis Response Group

Newsletter

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Obama Administration Releases Proposal to Address Financial Institutions that are “Too Big To Fail”

The Obama Administration proposed a new resolution mechanism to wind down failing large financial institutions previously deemed “too big to fail.” The proposal, supported by the FDIC and the Treasury Department, would be an alternative to bankruptcy and government bailouts.

Under the proposal, Congress would expand the FDIC’s resolution authority to cover large financial institutions. The FDIC would impose increased liquidity and capital requirements and would also be authorized to wind down failing institutions, swiftly replace board members and managers, and grant access to secured financing to mitigate the effects of a firm’s failure and fund its operations pending sale.

The proposal is designed to provide a way for large financial institutions to avoid the consequences of bankruptcy – generally considered to be inadequate to deal with the collapse of large, interconnected financial institutions – that would eliminate the need for any large-scale government bailouts, such as the Troubled Asset Relief Program enacted after the financial crisis of 2008. In addition, the proposal would prohibit any targeted assistance to specific open institutions.

FDIC Approves Phase Out of Temporary Liquidity Guarantee Program

On October 20, the FDIC issued a final rule allowing the Debt Guarantee Program (“DGP”) of the Temporary Liquidity Guaranty Program to expire as planned on October 31. The final rule also establishes a six-month emergency guarantee facility that current DGP participants may access on a case-by-case basis; the FDIC would assess a participation fee of at least 300 basis points on the FDIC-guaranteed debt issued.

Applicants to the emergency facility must be current DGP participants and must submit applications to the FDIC on or before April 30, 2010. Applicants would be required to demonstrate their inability to issue non-guaranteed debt or to replace maturing debt as a result of market disruptions or other circumstances beyond their control. The FDIC’s

guarantee issued under the emergency facility would expire no later than December 31, 2012.

FDIC Advisory Committee on Community Banking Holds First Meeting to Discuss Impact of the Financial Crisis on Community Banks

On October 15, the FDIC's Advisory Committee on Community Banking (the "Committee"), which was established in May, held its first meeting and discussed a number of topics, including the impact of the financial crisis on banks with less than \$1 billion of assets, the potential impact of various regulatory reform proposals by Congress and the FDIC on such banks, and the FDIC's Deposit Insurance Fund.

In particular, the Committee discussed whether the government should provide bridge capital to community banks, noting that while the public generally had a negative view of the Troubled Assets Relief Program, some community banks might benefit from bridge capital in order to avoid bank failures. The Committee noted that the FDIC's Deposit Insurance Fund decreased by 20 percent in the second quarter of 2009, which, according to the FDIC, was partially attributed to bank failures.

The FDIC established the Committee to provide it with advice and recommendations on a variety of issues affecting smaller banks and the communities they serve, including examination policies and procedures, credit and lending practices, deposit insurance assessments, insurance coverage issues, regulatory compliance matters and other obstacles to the growth and survival of community banks. The Committee is comprised of 14 community bankers and one representative from academia.

European Central Bank Comments on EU Alternative Investment Regulatory Proposal

On October 16, the European Central Bank (the "ECB") issued an opinion regarding the European Union's proposed regulation of investment managers advising hedge funds, private equity funds and other alternative investment vehicles. The ECB suggested that the European Union coordinate internationally, particularly with regulatory authorities in the United States, on rules to regulate such funds, and concluded that the current proposals could put Europe at a competitive disadvantage.

The ECB noted the potential risk of "regulatory arbitrage" by alternative investment managers if the EU imposes significantly tighter regulations than regulatory authorities in other jurisdictions. It also noted that the regulations being proposed for alternative investment managers create "an uneven playing field" with other financial intermediaries, such as credit institutions and insurance companies. The ECB expressed certain other concerns, pointing to the proposal's lack of specific leverage ratio concepts in the definition

of “leverage,” which the ECB identified as potentially problematic for the implementation of the new laws.

The EU’s proposals would require hedge fund managers and private equity firms overseeing at least 500 million Euros in assets to report to regulatory authorities. The Financial Services Authority in the United Kingdom estimates that compliance with the new rules, if adopted, could cost fund managers up to \$7.5 billion in additional expenditures.

HUD Announces \$60 Million in Housing Counseling Grants

On October 14, Shaun Donovan, Secretary of Housing and Urban Development, announced that HUD was granting \$60 million to national, regional, state and local agencies to improve the quality of housing counseling services and to provide training for counselors to become certified to assist families with housing issues. Recipients of grants may use the funds for a number of purposes, including: (1) assisting senior citizens seeking reverse mortgages or Home Equity Conversion Mortgages; (2) helping homebuyers and homeowners evaluate their readiness for a home purchase and understand financing options; and (3) assisting homeless persons find transitional housing. In addition, funds may also be used for counseling programs to combat predatory lending practices and other conditions that may result in a loss of equity, higher debt or foreclosure, such as unreasonably high interest rates, inflated appraisals, or unaffordable repayment terms.

House Committees Pass Bills to Regulate OTC Derivatives

On October 15, the House Financial Services Committee (“HFS”) passed proposed legislation, the Over-the-Counter Derivatives Markets Act of 2009, to regulate over-the-counter (“OTC”) derivatives. On October 21, the House Agriculture Committee (“HAC”) passed a similar bill. The committees held a number of hearings this year on proposals to regulate OTC derivatives and previously issued several versions of proposed legislation. HAC Chairman Colin Peterson, HFS Chairman Barney Frank, and other committee leaders will attempt to resolve differences so that a single bill can be sent to the full House for consideration.

Each bill provides for regulation of the OTC derivatives market, central clearing and trading for most standard OTC swaps, and a reporting requirement and higher margin and capital requirements for participants, and exempts parties that primarily hedge risk or that do not pose a risk to counterparties or financial systems from certain requirements. In contrast to the HFS bill, the HAC bill gives the CFTC jurisdiction over swaps not based on securities and the SEC jurisdiction over swaps based on securities. In addition, the HAC bill would generally not govern swaps based on government securities and options on futures commodity contracts, and would allow regulatory authorities to exempt certain parties (including “too big to fail” counterparties) from required clearing of derivatives swaps.

Proskauer's Economic Crisis Response Group includes lawyers with extensive experience representing private and public companies, institutional investors, financial services companies, private equity and hedge funds, lenders, commercial banks and individuals in the complex and interrelated areas impacted by the current financial situation. Our multidisciplinary group brings together the talents of our business and transactional lawyers with our litigation capabilities, particularly as they pertain to acquiring, managing or disposing of distressed assets; issues concerning investments in financial services companies; and complex financial instruments and transactions, including structured finance products; as well as a broad range of other areas such as corporate governance and defense, insurance coverage, reductions in force and other employment and benefit-related issues, securities regulation, and bankruptcy and restructuring matters.

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This publication is a service to our clients and friends. It is designed only to give general information on the developments actually covered. It is not intended to be a comprehensive summary of recent developments in the law, treat exhaustively the subjects covered, provide legal advice, or render a legal opinion.

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